



## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-95939; File No. SR-FINRA-2022-027]

### **Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change to Amend FINRA Rule 11892 (Clearly Erroneous Transactions in Exchange-Listed Securities)**

September 29, 2022

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on September 28, 2022, the Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I and II below, which Items have been prepared by FINRA. FINRA has designated the proposed rule change as constituting a “non-controversial” rule change under paragraph (f)(6) of Rule 19b-4 under the Act,<sup>3</sup> which renders the proposal effective upon receipt of this filing by the Commission. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

#### **I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change**

FINRA is proposing to amend FINRA Rule 11892 (Clearly Erroneous Transactions in Exchange-Listed Securities) to make the current clearly erroneous pilot

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> 17 CFR 240.19b-4(f)(6).

program permanent and limit the circumstances under which clearly erroneous review would be available.

The text of the proposed rule change is available on FINRA's website at <http://www.finra.org>, at the principal office of FINRA and at the Commission's Public Reference Room.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, FINRA included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. FINRA has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

On September 1, 2022, the Commission approved the proposal of Cboe BZX Exchange, Inc. ("BZX") to amend BZX Rule 11.17, Clearly Erroneous Executions, to: (1) make the current clearly erroneous pilot program permanent; and (2) limit the circumstances where clearly erroneous review would continue to be available during regular trading hours,<sup>4</sup> when the LULD Plan to Address Extraordinary Market Volatility (the "LULD Plan")<sup>5</sup> already provides similar protections for trades occurring at prices

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<sup>4</sup> Under BZX rules, the term "regular trading hours" means the time between 9:30 a.m. and 4:00 p.m. Eastern Time. See BZX Rule 1.5(w).

<sup>5</sup> See Securities Exchange Act Release No. 67091 (May 31, 2012), 77 FR 33498 (June 6, 2012).

that may be deemed erroneous.<sup>6</sup> FINRA now proposes to similarly amend FINRA’s rules for clearly erroneous transactions in exchange-listed securities to: (1) make the current clearly erroneous pilot program permanent; and (2) limit the circumstances where clearly erroneous review would continue to be available during normal market hours,<sup>7</sup> when the LULD Plan already provides similar protections for trades occurring at prices that may be deemed erroneous.<sup>8</sup> FINRA believes that these changes are appropriate as the LULD Plan has been approved by the Commission on a permanent basis,<sup>9</sup> and in light of amendments to the LULD Plan, including changes to the applicable price bands<sup>10</sup> around the open and close of trading.

#### Proposal to Make the Clearly Erroneous Pilot Permanent

On September 10, 2010, the Commission approved, on a pilot basis, changes to FINRA Rule 11892 that, among other things: (i) provided for uniform treatment of clearly erroneous execution reviews in multi-stock events involving twenty or more securities; and (ii) reduced the ability of FINRA to deviate from the objective standards

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<sup>6</sup> See Securities Exchange Act Release No. 95658 (September 1, 2022), 87 FR 55060 (September 8, 2022) (Order Approving File No. SR-CboeBZX-2022-037).

<sup>7</sup> The term “normal market hours” means the time between 9:30 a.m. and 4:00 p.m. Eastern Time. See FINRA Rule 11892(b)(1) (proposed to be moved to FINRA Rule 11892(a)(1)).

<sup>8</sup> FINRA understands that the other self-regulatory organizations (“SROs”) have or will similarly submit to the Commission substantively identical proposals.

<sup>9</sup> See Securities Exchange Act Release No. 84843 (December 18, 2018), 83 FR 66464 (December 26, 2018) (“Notice”); 85623 (April 11, 2019), 84 FR 16086 (April 17, 2019) (File No. 4-631) (“Amendment Eighteen”).

<sup>10</sup> “Price bands” refers to the term provided in Section V of the LULD Plan.

set forth in the rule.<sup>11</sup> In 2013, FINRA adopted a provision designed to address the operation of the LULD Plan.<sup>12</sup> Finally, in 2014, FINRA adopted two additional provisions providing that: (i) a series of transactions in a particular security on one or more trading days may be viewed as one event if all such transactions were effected based on the same fundamentally incorrect or grossly misinterpreted issuance information resulting in a severe valuation error for all such transactions; and (ii) in the event of any disruption or malfunction in the operation of the electronic communications and trading facilities of a SRO or responsible single plan processor in connection with the transmittal or receipt of a trading halt, a FINRA Officer, acting on his or her own motion, shall nullify any transaction that occurs after a trading halt has been declared by the primary listing market for a security and before such trading halt has officially ended according to the primary listing market.<sup>13</sup> These changes are currently scheduled to operate for a pilot period that would end at the close of business on October 20, 2022.<sup>14</sup>

When it originally approved the clearly erroneous pilot, the Commission explained that the changes were “being implemented on a pilot basis so that the Commission and FINRA can monitor the effects of the pilot on the markets and

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<sup>11</sup> See Securities Exchange Act Release No. 62885 (September 10, 2010), 75 FR 56641 (September 16, 2010) (Order Approving File No. SR-FINRA-2010-032).

<sup>12</sup> See Securities Exchange Act Release No. 68808 (February 1, 2013), 78 FR 9083 (February 7, 2013) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2013-012).

<sup>13</sup> See Securities Exchange Act Release No. 72434 (June 19, 2014), 79 FR 36110 (June 25, 2014) (Order Approving File No. SR-FINRA-2014-021).

<sup>14</sup> See Securities Exchange Act Release No. 95322 (July 19, 2022), 87 FR 44160 (July 25, 2022) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2022-020).

investors, and consider appropriate adjustments, as necessary.”<sup>15</sup> In the 12 years since that time, FINRA and the national securities exchanges have gained considerable experience in the operation of the rule, as amended on a pilot basis. Based on that experience, FINRA believes that the program should be allowed to continue on a permanent basis so that equities market participants and investors can benefit from the increased certainty provided by the amended rule.

The clearly erroneous pilot was implemented following a severe disruption in the U.S. equities markets on May 6, 2010 (“Flash Crash”) to “provide greater transparency and certainty to the process of breaking trades.”<sup>16</sup> Largely, the pilot reduced the discretion of FINRA and the national securities exchanges to deviate from the objective standards in their respective rules when dealing with potentially erroneous transactions. The pilot has thus helped afford greater certainty to members and investors about when trades will be deemed erroneous pursuant to SRO rules and has provided a more transparent process for conducting such reviews. FINRA proposes to make the current pilot permanent so that market participants can continue to benefit from the increased certainty afforded by the current rule.<sup>17</sup>

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<sup>15</sup> See Securities Exchange Act Release No. 62885 (September 10, 2010), 75 FR 56641, 56645 (September 16, 2010) (Order Approving File No. SR-FINRA-2010-032).

<sup>16</sup> See 75 FR 56641, 56642.

<sup>17</sup> To accomplish this, FINRA proposes to remove the text of existing Supplementary Material .02 of FINRA Rule 11892, which currently provides that the amendments set forth in File Nos. SR-FINRA-2010-032 and SR-FINRA-2014-021, and the provisions of Supplementary Material .03 of this Rule shall be in effect during a pilot period that expires at the close of business on October 20, 2022. Existing Supplementary Material .02 further provides that, if the pilot period is not extended or approved as permanent, the version of this Rule prior to SR-FINRA-2010-032 shall be in effect, and the amendments set forth in File No.

### Amendments to the Clearly Erroneous Rules

When the Participants to the LULD Plan filed to introduce the Limit Up-Limit Down (“LULD”) mechanism, itself a response to the Flash Crash, a handful of commenters noted the potential discordance between the clearly erroneous rules and the Price Bands used to limit the price at which trades would be permitted to be executed pursuant to the LULD Plan. For example, two commenters requested that the clearly erroneous rules be amended so the presumption would be that trades executed within the Price Bands would not be subject to review.<sup>18</sup> While the Participants acknowledged that the potential to prevent clearly erroneous executions would be a “key benefit” of the LULD Plan, the Participants decided not to amend the clearly erroneous rules at that time.<sup>19</sup> In the years since, industry feedback has continued to reflect a desire to eliminate the discordance between the LULD mechanism and the clearly erroneous rules so that market participants would have more certainty that trades executed within the LULD price bands would stand. For example, the Equity Market Structure Advisory Committee (“EMSAC”) Market Quality Subcommittee included in its April 19, 2016 status report a preliminary recommendation that clearly erroneous rules be amended to conform to the price bands – i.e., “any trade that takes place within the band would stand and not be

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SR-FINRA-2014-021 and the provisions of Supplementary Material .03 of this Rule shall be null and void.

<sup>18</sup> See Securities Exchange Act Release No. 67091 (May 31, 2012), 77 FR 33498, 33505 (June 6, 2012) (File No. 4-631).

<sup>19</sup> See supra note 18.

broken and trades outside the LU/LD bands would be eligible for the consideration of the Clearly Erroneous rules.”<sup>20</sup>

FINRA believes that it is important for there to be some mechanism to ensure that investors’ orders are either not executed at clearly erroneous prices or are subsequently busted as needed to maintain a fair and orderly market. At the same time, FINRA believes that the LULD Plan, as amended, would provide sufficient protection for trades executed during normal market hours. Indeed, the LULD mechanism could be considered to offer superior protection as it prevents potentially erroneous trades from being executed in the first instance. After gaining experience with the LULD Plan, FINRA now believes that it is appropriate to largely eliminate clearly erroneous review during normal market hours when price bands are in effect. Thus, as proposed, trades executed within the price bands would stand, barring one of a handful of identified scenarios where such review may still be necessary for the protection of investors. FINRA believes that this change would be beneficial for the U.S. equities markets as it would ensure that trades executed within the price bands are subject to clearly erroneous review in only rare circumstances, resulting in greater certainty for members and investors.

The current LULD mechanism for addressing extraordinary market volatility is available solely during normal market hours. Thus, trades outside of normal market hours would not benefit from this protection and could ultimately be executed at prices

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<sup>20</sup> See EMSAC Market Quality Subcommittee, Recommendations for Rulemaking on Issues of Market Quality (November 29, 2016), available at <https://www.sec.gov/spotlight/emsac/emsac-recommendations-rulemaking-market-quality.pdf>.

that may be considered erroneous. For this reason, FINRA proposes that transactions executed outside of normal market hours would continue to be reviewable as clearly erroneous. Continued availability of the clearly erroneous rule at times outside of normal market hours would therefore ensure that FINRA has appropriate authority when erroneous trades are executed outside of the hours where similar protection can be provided by the LULD Plan. Further, the proposal is designed to eliminate the potential discordance between clearly erroneous review and LULD price bands, which does not exist outside of normal market hours because the LULD Plan is not in effect. Thus, FINRA believes that it is appropriate to continue to allow transactions to be eligible for clearly erroneous review if executed outside of normal market hours.

On the other hand, there would be much more limited potential for clearly erroneous transactions during normal market hours. With the introduction of the LULD mechanism in 2013, clearly erroneous trades are largely prevented by the requirement that trades be executed within the price bands. In addition, in 2019, Amendment Eighteen to the LULD Plan eliminated double-wide price bands: (1) at the open, and (2) at the close for Tier 2 NMS Stocks 2 with a reference price above \$3.00.<sup>21</sup> Due to these changes, FINRA believes that the price bands would provide sufficient protection to investor orders such that clearly erroneous review would no longer be necessary during normal market hours. As the Participants to the LULD Plan explained in Amendment Eighteen: “[b]roadly, the Limit Up-Limit Down mechanism prevents trades from happening at prices where one party to the trade would be considered ‘aggrieved,’ and thus could be viewed as an appropriate mechanism to supplant clearly erroneous rules.”

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<sup>21</sup> See Amendment Eighteen, supra note 9.

While the Participants also expressed concern that the price bands might be too wide to afford meaningful protection around the open and close of trading, amendments to the LULD Plan adopted in Amendment Eighteen narrowed price bands at these times in a manner that FINRA believes is sufficient to ensure that investors' orders would be appropriately protected in the absence of clearly erroneous review. FINRA therefore believes that it is appropriate to rely on the LULD mechanism as the primary means of preventing clearly erroneous trades during normal market hours.

At the same time, FINRA is cognizant that there may be limited circumstances where clearly erroneous review may continue to be appropriate, even during normal market hours. Thus, FINRA proposes to amend its clearly erroneous rules to enumerate the specific circumstances where such review would remain available during the course of normal market hours, as follows. All transactions that fall outside of these specific enumerated exceptions would be ineligible for clearly erroneous review.

First, pursuant to proposed paragraph (b)(1)(A), a transaction executed during normal market hours would continue to be eligible for clearly erroneous review if the transaction is not subject to the LULD Plan. In such case, the numerical guidelines set forth in paragraph (b)(2) of FINRA Rule 11892 will be applicable to such NMS stock. While the majority of exchange-listed securities would be subject to the LULD Plan, certain equity securities, such as rights and warrants, are explicitly excluded from the provisions of the LULD Plan and would therefore be eligible for clearly erroneous review instead.<sup>22</sup> Similarly, there are instances, such as the opening auction on the primary

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<sup>22</sup> See Appendix A of the LULD Plan.

listing market,<sup>23</sup> where transactions are not ordinarily subject to the LULD Plan, or circumstances where a transaction that ordinarily would have been subject to the LULD Plan is not–due, for example, to some issue with processing the price bands. These transactions would continue to be eligible for clearly erroneous review, effectively ensuring that such review remains available as a backstop when the LULD Plan would not prevent executions from occurring at erroneous prices in the first instance.

Second, transactions that resulted from certain systems issues pursuant to proposed paragraph (b)(1)(B) would continue to be eligible for clearly erroneous review. This limited exception would help to ensure that trades that should not have been executed would continue to be subject to clearly erroneous review. Specifically, as proposed, transactions executed during normal market hours would be eligible for clearly erroneous review pursuant to proposed paragraph (b)(1)(B) if as a result of a member’s technology or systems issue any transaction reported to a FINRA system, such as a FINRA TRF or ADF, occurs outside of the applicable LULD price bands pursuant to Supplementary Material .02 of FINRA Rule 11892. A transaction subject to review pursuant to this paragraph shall be found to be clearly erroneous if the price of the subject transaction to buy (sell) is greater than (less than) the reference price, described in proposed paragraph (c) of FINRA Rule 11892, by an amount that equals or exceeds the applicable “percentage parameter,” as defined in Appendix A to the LULD Plan.

Third, FINRA proposes to narrowly allow for the review of transactions during normal market hours when the reference price, described in proposed paragraph (c), is

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<sup>23</sup> The initial reference price used to calculate price bands is typically set by the opening price on the primary listing market. See Section V(B) of the LULD Plan.

determined to be erroneous by a FINRA officer. Specifically, a transaction executed during normal market hours would be eligible for clearly erroneous review pursuant to proposed paragraph (b)(1)(C) if the transaction involved, in the case of (1) a corporate action or new issue or (2) a security that enters a trading pause pursuant to the LULD Plan and resumes trading without an auction,<sup>24</sup> a reference price that is determined to be erroneous by a FINRA officer because it clearly deviated from the theoretical value of the security. In such circumstances, FINRA may use a different reference price pursuant to proposed paragraph (c)(2) of FINRA Rule 11892. A transaction subject to review pursuant to this paragraph shall be found to be clearly erroneous if the price of the subject transaction to buy (sell) is greater than (less than) the new reference price, described in paragraph (c)(2) of FINRA Rule 11892, by an amount that equals or exceeds the applicable numerical guidelines or percentage parameters, as applicable depending on whether the security is subject to the LULD Plan. Specifically, the percentage parameters would apply to all transactions except those in an NMS Stock that is not subject to the LULD Plan, as described in paragraph (b)(1)(A).

In the context of a corporate action or a new issue, there may be instances where the security's reference price is later determined FINRA to be erroneous (e.g., because of a bad first trade for a new issue), and subsequent LULD price bands are calculated from that incorrect reference price. In determining whether the reference price is erroneous in such instances, FINRA would generally look to see if such reference price clearly deviated from the theoretical value of the security. In such cases, FINRA would consider

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<sup>24</sup> FINRA notes that the "resumption of trading without an auction" provision of the proposed rule text applies only to securities that enter a trading pause pursuant to LULD and does not apply to a corporate action or new issue.

a number of factors to determine a new reference price that is based on the theoretical value of the security, including but not limited to, the offering price of the new issue, the ratio of the stock split applied to the prior day's closing price, the theoretical price derived from the numerical terms of the corporate action transaction such as the exchange ratio and spin-off terms, and the prior day's closing price on the over-the-counter ("OTC") market for an OTC up-listing.<sup>25</sup> In the foregoing instances, the theoretical value of the security would be used as the new reference price when applying the percentage parameters under the LULD Plan (or numerical guidelines if the transaction is in an NMS stock that is not subject to the LULD Plan) to determine whether executions would be cancelled as clearly erroneous.

The following illustrate the proposed application of the rule in the context of a corporate action or new issue:

Example 1:

1. ABCD is subject to a corporate action, 1 for 10 reverse split, and the previous day close was \$5, but the new theoretical price based on the terms of the corporate action is \$50
2. The security opens at \$5, with LULD bands at \$4.50 x \$5.50
3. The bands will be calculated correctly but the security is trading at an erroneous price based on the valuation of the remaining outstanding shares
4. The theoretical price of \$50 would be used as the new reference price when applying LULD bands to determine if executions would be cancelled as clearly erroneous

Example 2:

1. ABCD is subject to a corporate action, the company is doing a spin off where a new issue will be listed, BCDE. ABCD trades at \$50, and the spinoff company is worth 1/5 of ABCD

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<sup>25</sup> Using transaction data reported to the FINRA OTC Reporting Facility, FINRA disseminates via the Trade Data Dissemination Service a final closing report for OTC equity securities for each business day that includes, among other things, each security's closing last sale price.

2. BCDE opens at \$50 in the belief it is the same company as ABCD
3. The theoretical values of the two companies are ABCD \$40 and BCDE \$10
4. BCDE would be deemed to have had an incorrect reference price and the theoretical value of \$10 would be used as the new reference price when applying the LULD bands to determine if executions would be cancelled as clearly erroneous

Example 3:

1. ABCD is an up-list from the OTC market, the prior day's close on the OTC market was \$20
2. ABCD opens trading on the new listing exchange at \$0.20 due to an erroneous order entry
3. The new reference price to determine clearly erroneous executions would be \$20, the theoretical value of the stock based on where it was last traded

In the context of the rare situation in which a security that enters a LULD trading pause and resumes trading without an auction (i.e., reopens with quotations), the LULD Plan requires that the new reference price in this instance be established by using the mid-point of the best bid and offer ("BBO") on the primary listing exchange at the reopening time.<sup>26</sup> This can result in a reference price and subsequent LULD price band calculation that is significantly away from the security's last traded or more relevant price, especially in less liquid names. In such rare instances, FINRA is proposing to use a different reference price that is based on the prior LULD band that triggered the trading pause, rather than the midpoint of the BBO.

The following example illustrates the proposed application of the rule in the context of a security that reopens without an auction:

Example 4:

1. ABCD stock is trading at \$20, with LULD bands at \$18 x \$22
2. An incoming buy order causes the stock to enter a limit state trading pause and then a trading pause at \$22
3. During the trading pause, the buy order causing the trading pause is cancelled

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<sup>26</sup> See LULD Plan, Section I(U) and V(C)(1).

4. At the end of the 5-minute halt, there is no crossed interest for an auction to occur, thus trading would resume on a quote
5. Upon resumption, a quote that was available prior to the trading pause (e.g., a quote was resting on the book prior to the trading pause), is widely set at \$10 x \$90
6. The reference price upon resumption is \$50 (mid-point of BBO)
7. The SIP will use this reference price and publish LULD bands of \$45 x \$55 (i.e., far away from BBO prior to the halt)
8. The bands will be calculated correctly, but the \$50 reference price is subsequently determined to be incorrect as the price clearly deviated from where it previously traded prior to the trading pause
9. The new reference price would be \$22 (i.e., the last effective price band that was in a limit state before the trading pause), and the LULD bands would be applied to determine if the executions should be cancelled as clearly erroneous

In all of the foregoing situations, FINRA would not have authority to review transactions as clearly erroneous without the proposed carveouts in paragraph (b)(1)(C) because the trades occurred within the LULD price bands (albeit LULD price bands that were calculated from an erroneous reference price). FINRA believes that removing the current ability for FINRA to review in these narrow circumstances would lessen investor protections.

#### Numerical Guidelines

Today, paragraph (b)(1) defines the numerical guidelines that are used to determine if a transaction is deemed clearly erroneous during normal market hours, or outside of normal market hours. With respect to normal market hours, trades are generally deemed clearly erroneous if the execution price differs from the reference price (i.e., last sale) by 10% if the reference price is greater than \$0.00 up to and including \$25.00; 5% if the reference price is greater than \$25.00 up to and including \$50.00; and 3% if the reference price is greater than \$50.00. Wider parameters are also used for reviews for multi-stock events, as described in paragraph (b)(2). With respect to transactions in leveraged ETF/ETN securities executed during normal market hours and

outside of normal market hours, trades are deemed clearly erroneous if the execution price exceeds the normal market hours numerical guidelines multiplied by the leverage multiplier.

Given the changes described in this proposed rule change, FINRA proposes to amend the way that the numerical guidelines are calculated during normal market hours in the handful of instances where clearly erroneous review would continue to be available. Specifically, FINRA would base these numerical guidelines, as applied to the circumstances described in paragraph (b)(1)(A), on the percentage parameters used to calculate price bands, as set forth in Appendix A to the LULD Plan. Without this change, a transaction that would otherwise stand if price bands were properly applied to the transaction may end up being subject to review and deemed clearly erroneous solely due to the fact that the price bands were not available due to a systems or other issue. FINRA believes that it makes more sense to instead base the price bands on the same parameters as would otherwise determine whether the trade would have been allowed to execute within the price bands. FINRA also proposes to modify the numerical guidelines applicable to leveraged ETF/ETN securities during normal market hours. As noted above, the numerical guidelines will only be applicable to transactions eligible for review pursuant paragraph (b)(1)(A) (i.e., to NMS stocks that are not subject to the LULD Plan). As leveraged ETF/ETN securities are subject to LULD and thus the percentage parameters will be applicable during normal market hours, FINRA proposes to eliminate the numerical guidelines for leveraged ETF/ETN securities traded during normal market hours. However, as no price bands are available outside of normal market hours, FINRA

proposes to keep the existing numerical guidelines in place for transactions in leveraged ETF/ETN securities that occur outside of normal market hours.

FINRA also proposes to move existing paragraphs (b)(2) and (b)(3) to proposed paragraph (b)(2)(B) and (b)(2)(C), respectively, as multi-stock events and additional factors will only be subject to review if those NMS stocks are not subject to the LULD Plan or occur outside of normal market hours. Proposed paragraph (b)(2)(B) is substantially similar to existing paragraph (b)(2) except to update the opening language to limit application of paragraph (b)(2)(B) to multi-stock events occurring outside of normal market hours or eligible for review pursuant to paragraph (b)(1)(A). Proposed paragraph (b)(2)(C) is also substantially similar to existing paragraph (b)(3) except to update its application to executions occurring outside of normal market hours or eligible for review pursuant to paragraph (b)(1)(A).

#### Reference Price

As proposed, the reference price used would continue to be based on last sale and would be memorialized in proposed paragraph (c). Continuing to use the last sale as the reference price is necessary for operational efficiency as it may not be possible to perform a timely clearly erroneous review if doing so required computing the arithmetic mean price of eligible reported transactions over the past five minutes, as contemplated by the LULD Plan. While this means that there would still be some differences between the price bands and the clearly erroneous parameters, FINRA believes that this difference is reasonable in light of the need to ensure timely review if clearly erroneous rules are invoked. FINRA also proposes to allow for an alternate reference price to be used as prescribed in proposed paragraphs (c)(1), (2), and (3). Specifically, the reference price

may be a value other than the consolidated last sale immediately prior to the execution(s) under review: (1) in the case of multi-stock events involving twenty or more securities, as described in paragraph (b)(2)(B); (2) in the case of an erroneous reference price, as described in paragraph (b)(1)(C);<sup>27</sup> or (3) in other circumstances, such as, for example, relevant news impacting a security or securities, periods of extreme market volatility, sustained illiquidity, or widespread system issues, where use of a different reference price is necessary for the maintenance of a fair and orderly market and the protection of investors and the public interest, provided that such circumstances occurred outside of normal market hours or are eligible for review pursuant to paragraph (b)(1)(A).

#### Procedures for Reviewing Transactions

Paragraph (a)(1) sets forth the procedures for reviewing transactions under FINRA Rule 11892 and currently provides that a FINRA officer may, on his or her own motion, review any OTC transaction involving an exchange-listed security arising out of or reported through a trade reporting system owned or operated by FINRA or FINRA Regulation and authorized by the Commission, provided that the transaction meets the thresholds set forth in paragraph (b), except as provided for in paragraphs (c) and (d). In light of the proposed structural changes to the Rule described above, FINRA proposes to amend paragraph (a)(1) to clarify that such review is only available for transactions

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<sup>27</sup> As discussed above, in the case of (b)(1)(C)(1), FINRA would consider a number of factors to determine a new reference price that is based on the theoretical value of the security, including but not limited to, the offering price of the new issue, the ratio of the stock split applied to the prior day's closing price, the theoretical price derived from the numerical terms of the corporate action transaction such as the exchange ratio and spin-off terms, and the prior day's closing price on the OTC market for an OTC up-listing. In the case of (b)(1)(C)(2), the reference price will be the last effective price band that was in a limit state before the trading pause.

occurring outside of normal market hours or eligible for review pursuant to paragraph (b)(1), and to conform and streamline other language and references throughout paragraph (a)(1).<sup>28</sup>

### Appeals

Paragraph (a)(2) currently provides that if a FINRA officer acting pursuant to FINRA Rule 11892 declares any transaction null and void, each party involved in the transaction shall be notified as soon as practicable by FINRA, and the party aggrieved by the action may appeal such action in accordance with Rule 11894, unless the officer making the determination also determines that the number of the affected transactions is such that immediate finality is necessary to maintain a fair and orderly market and to protect investors and the public interest, and further provided that rulings made by FINRA in conjunction with one or more other self-regulatory organizations are not appealable. Consistent with the proposed structural changes to the Rule described above, FINRA proposes to amend paragraph (a)(2) to remove the limitation on appeals where the officer determines that the number of affected transactions is such that immediate finality is necessary, and to add a limitation on appeals where the decision is made by an officer under Supplementary Material .02 of FINRA Rule 11892 regarding transactions that occurred outside of the applicable Price Bands disseminated pursuant to the LULD Plan.<sup>29</sup>

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<sup>28</sup> As noted above, given that the term “normal market hours” would now appear in paragraph (a)(1) of the Rule, FINRA proposes to define it here rather than in paragraph (b).

<sup>29</sup> In connection with these proposed changes, FINRA is also proposing conforming edits to paragraph (a) of FINRA Rule 11894 (Review by the Uniform Practice

### Securities Subject to Limit Up-Limit Down Plan

FINRA proposes to renumber Supplementary Material .03 as Supplementary Material .02 based on the proposal to eliminate existing paragraph Supplementary Material .02, and to rename new Supplementary Material .02 to address transactions occurring outside of LULD price bands. Given that proposed paragraph (b)(1) defines the LULD Plan, FINRA also proposes to eliminate redundant language from proposed Supplementary Material .02. Finally, FINRA also proposes to update references to the LULD Plan and price bands so that they are uniform throughout the Rule, to update rule references throughout the paragraph to conform to the structural changes to the Rule described above, and to renumber paragraphs (b) and (c) of Supplementary Material .02 to paragraphs (a) and (b) given the proposed deletion of existing paragraph (a).

### Multi-Day Event and Trading Halts

FINRA proposes to renumber paragraphs (c) and (d) to paragraphs (d) and (e), respectively, based on the proposal to add new paragraph (c). Additionally, FINRA proposes to modify the text of both paragraphs to reference the percentage parameters as well as the numerical guidelines. Specifically, the existing text of proposed paragraphs (d) and (e) provides that any action taken in connection with this paragraph will be taken without regard to the numerical guidelines set forth in this Rule. FINRA proposes to amend the rule text to provide that any action taken in connection with this paragraph will be taken without regard to the percentage parameters or numerical guidelines set forth in this Rule, with the percentage parameters being applicable to an NMS stock

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Code (“UPC”) Committee, which includes parallel provisions relating to the availability of appeals.

subject to the LULD Plan and the numerical guidelines being applicable to an NMS stock not subject to the LULD Plan.

FINRA has filed the proposed rule change for immediate effectiveness and has requested that the SEC waive the requirement that the proposed rule change not become operative for 30 days after the date of the filing, so FINRA can implement the proposed rule change on October 1, 2022.

## 2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,<sup>30</sup> which requires, among other things, that FINRA rules must be designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.

As explained in the purpose section of this proposed rule change, the current pilot was implemented following the Flash Crash to bring greater transparency to the process for conducting clearly erroneous reviews, and to help assure that the review process is based on clear, objective, and consistent rules across the U.S. equities markets. FINRA believes that the amended clearly erroneous rules have been successful in that regard and have thus furthered fair and orderly markets. Specifically, FINRA believes that the pilot has successfully ensured that such reviews are conducted based on objective and consistent standards across SROs and has therefore afforded greater certainty to members and investors. FINRA therefore believes that making the current pilot a permanent program is appropriate so that equities market participants can continue to reap the

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<sup>30</sup> 15 U.S.C. 78o-3(b)(6).

benefits of a clear, objective, and transparent process for conducting clearly erroneous reviews. In addition, FINRA understands that the U.S. equities exchanges have or will also file largely identical proposals to make their respective clearly erroneous pilots permanent. FINRA therefore believes that the proposed rule change would promote transparency and uniformity across markets concerning review of transactions as clearly erroneous and would also help assure consistent results in handling erroneous trades across the U.S. equities markets, thus furthering fair and orderly markets, the protection of investors, and the public interest.

Similarly, FINRA believes that it is consistent with just and equitable principles of trade to limit the availability of clearly erroneous review during normal market hours. The LULD Plan was approved by the Commission to operate on a permanent rather than pilot basis. As a number of market participants have noted, the LULD Plan provides protections that ensure that investors' orders are not executed at prices that may be considered clearly erroneous. Further, amendments to the LULD Plan approved in Amendment Eighteen serve to ensure that the price bands established by the LULD Plan are "appropriately tailored to prevent trades that are so far from current market prices that they would be viewed as having been executed in error."<sup>31</sup> Thus, FINRA believes that clearly erroneous review should only be necessary in very limited circumstances during normal market hours. Specifically, such review would only be necessary in instances where a transaction was not subject to the LULD Plan, or was the result of some form of systems issue, as detailed in the purpose section of this proposed rule change. Additionally, in narrow circumstances where the transaction was subject to the LULD

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<sup>31</sup> See Amendment Eighteen, supra note 9.

Plan, a clearly erroneous review would be available in the case of (1) a corporate action or new issue or (2) a security that enters a trading pause pursuant to LULD and resumes trading without an auction, where the reference price is determined to be erroneous by a FINRA officer because it clearly deviated from the theoretical value of the security. Thus, eliminating clearly erroneous review in all other instances will serve to increase certainty for members and investors that trades executed during normal market hours would typically stand and would not be subject to review.

Given the fact that clearly erroneous review would largely be limited to transactions that were not subject to the LULD Plan, FINRA also believes that it is necessary to change the parameters used to determine whether a trade is clearly erroneous. Specifically, due to the different parameters currently used for clearly erroneous review and for determining price bands, it is possible that a trade that would have been permitted to execute within the price bands would later be deemed clearly erroneous, if, for example, a systems issue prevented the dissemination of the price bands. FINRA believes that this result is contrary to the principle that trades within the price bands should stand, and has the potential to cause investor confusion if trades that are properly executed within the applicable parameters described in the LULD Plan are later deemed erroneous. By using consistent parameters for clearly erroneous reviews conducted during normal market hours and the calculation of the price bands, FINRA believes that this change would also serve to promote greater certainty with regards to when trades may be deemed erroneous.

Finally, the proposed rule change makes organizational updates to FINRA Rule 11892, as well as minor updates and corrections to the Rule to improve readability and clarity and conforming edits to FINRA Rule 11894.

B. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. The proposed rule change would ensure the continued, uninterrupted operation of harmonized clearly erroneous execution rules across the U.S. equities markets while also amending those rules to provide greater certainty to members and investors that trades will stand if executed during normal market hours where the LULD Plan provides adequate protection against trading at erroneous prices. FINRA understands that the national securities exchanges have or will also file similar proposals, the substance of which are largely identical to this proposed rule change. Thus, the proposed rule change will help to ensure consistency across SROs without implicating any competitive issues.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments were neither solicited nor received.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Because the foregoing proposed rule change does not: (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days from the date on which it was filed,

or such shorter time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>32</sup> and Rule 19b-4(f)(6) thereunder.<sup>33</sup>

A proposed rule change filed under Rule 19b-4(f)(6)<sup>34</sup> normally does not become operative prior to 30 days after the date of the filing. However, Rule 19b-4(f)(6)(iii)<sup>35</sup> permits the Commission to designate a shorter time if such action is consistent with the protection of investors and the public interest. FINRA has asked the Commission to waive the 30-day operative delay so that the proposed rule change may become operative on October 1, 2022. The Commission believes that waiving the 30-day operative delay is consistent with the protection of investors and the public interest, as it will allow FINRA to coordinate its implementation of the revised clearly erroneous execution rules with the national securities exchanges, and will help ensure consistency across the SROs.<sup>36</sup> For this reason, the Commission hereby waives the 30-day operative delay and designates the proposed rule change as operative upon filing.<sup>37</sup>

At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act. If the

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<sup>32</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>33</sup> 17 CFR 240.19b-4(f)(6).

<sup>34</sup> 17 CFR 240.19b-4(f)(6).

<sup>35</sup> 17 CFR 240.19b-4(f)(6)(iii).

<sup>36</sup> See SR-CboeBZX-2022-37 (July 8, 2022).

<sup>37</sup> For purposes only of waiving the 30-day operative delay, the Commission has also considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

Commission takes such action, the Commission shall institute proceedings to determine whether the proposed rule should be approved or disapproved.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

##### Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-FINRA-2022-027 on the subject line.

##### Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-FINRA-2022-027. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for

website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2022-027 and should be submitted on or before **[INSERT DATE 21 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>38</sup>

**J. Matthew DeLesDernier,**  
*Deputy Secretary.*

[FR Doc. 2022-21560 Filed: 10/4/2022 8:45 am; Publication Date: 10/5/2022]

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<sup>38</sup> 17 CFR 200.30-3(a)(12).